service & technology

annual report of The Island Telephone Company Limited for 1977

1977 Annual Report to the shareholders

THE ISLAND TELEPHONE COMPANY LIMITED

Incorporated under the laws of the Province of Prince Edward Island
Head Office: 71 Belvedere Avenue, Charlottetown, Prince Edward Island, Canada C1A 1R5
Telephone (Area Code 902) 894-5501

REGISTRAR AND STOCK TRANSFER OFFICES

Canada Permanent Trust Company
129 Kent Street, Charlottetown, P.E.I.
(Common shares, 4-1/2% Preference shares,
4-3/4% Preference shares, 5-1/2% Preference shares,
7-1/4% Preference shares, 9-1/4% Preference shares, and
9-1/4% (1977 series) Preference shares)

600 Dorchester Boulevard, West, Montreal 101, Quebec
(Common shares, 5-1/2% Preference shares, 7-1/4% Preference shares,
9-1/4% Preference shares and 9-1/4% (1977 series) Preference shares

20 Eglinton Avenue, West, Toronto 1, Ontario
(Common shares, 7-1/4% Preference shares, 9-1/4%
Preference shares and 9-1/4% (1977 series) Preference shares

315 Eighth Avenue, S.W. Calgary, Alberta
(Common shares, 9-1/4% Preference shares and 9-1/4% (1977)
Preference shares

701 West Georgia Street, Vancouver, B.C.
(5-1/2% Preference shares)

1646 Barrington Street, Halifax, N.S.
(Common shares, 5-1/2% Preference shares, 7-1/4%
Preference shares, 9-1/4% Preference shares
and 9-1/4% (1977 series) Preference shares

COMMON SHARES LISTED

Montreal Stock Exchange
Toronto Stock Exchange

VALUATION DAY PRICES

(December 22, 1971)

Common Shares	
4-1/2% Preference shares	—$10.25
4-1/2% Preference shares	—$ 6.25
4-3/4% Preference shares	—$ 6.60
5-1/2% Preference shares	—$15.25

This 1977 Annual Report is a summary of the operations of the Company in its service to the people of Prince Edward Island. It is prepared for those who have invested in our Company, for those who are interested in the Company's performance and for our employees.

ANNUAL MEETING

The annual general meeting of the
shareholders of The Island Telephone
Company Limited will be held at
the Head Office of the Company
71 Belvedere Avenue, Charlottetown, P.E.I.
Tuesday, May 30, 1978 at 11:30 o'clock in the forenoon.

From the President

The Island Telephone Company is constantly striving to provide high quality service at reasonable rates. Modern technology has been used to assist in achieving this goal and, during 1977, significant advances were made in the provision of a modern and efficient telecommunication system to meet growth in service requirements and to provide improved service.

This was highlighted by the attainment in 1977 of a major service improvement milestone: 100 per cent dial service. With the conversion of the Tyne Valley exchange to dial operation on November 30, along with five other exchanges also converted in 1977, the Company completed its ten year program to provide dial service throughout the Province.

All exchanges are now dial operated and all customers have Direct Distance Dial service enabling them to dial any of the 170 million telephones on the North American continent.

In addition to improving service your Company is continuing to grow to meet steadily increasing requirements for telecommunication service. During 1977 the growth in telephones in service was among the highest in Canada with nearly three thousand telephones added to the network, a growth of 5.7 per cent, and long distance calling increased 9.2 per cent.

The facilities necessary to provide for this growth in calling, together with the service improvement program, required a record high level of capital expenditures in 1977; and to raise a part of these capital expenditures, the Company completed an extensive financing program during the year by issuing common and preference stock and first mortgage bonds.

I.E.H. Duvar

Satisfactory earnings are required to support the capital investment necessary for effective and efficient telephone service and, at year end, earnings per share increased over 1976 earnings by 13 cents to $1.74 a share. Similarly, the rate of return

on total invested capital increased to 10.4 per cent and the return on average common equity to 14.1 per cent.

These improved earnings were made possible by increased revenue from the growth in telephone service, greater use of long distance calling and increased employee productivity, as well as additional revenue from the increased rates approved by the Public Utilities Commission for implementation March 1, 1977.

The modern, up-to-date telecommunications network on the Island has been achieved through the use of such technological advances as microwave and digital transmission systems, and electronic and electromechanical switching exchanges.

Efficient operation of this network depends on our skilled team of employees, whose extensive knowledge of advanced technology is essential in modern day telecommunications, and who are dedicated to providing a high quality service to residents of Prince Edward Island.

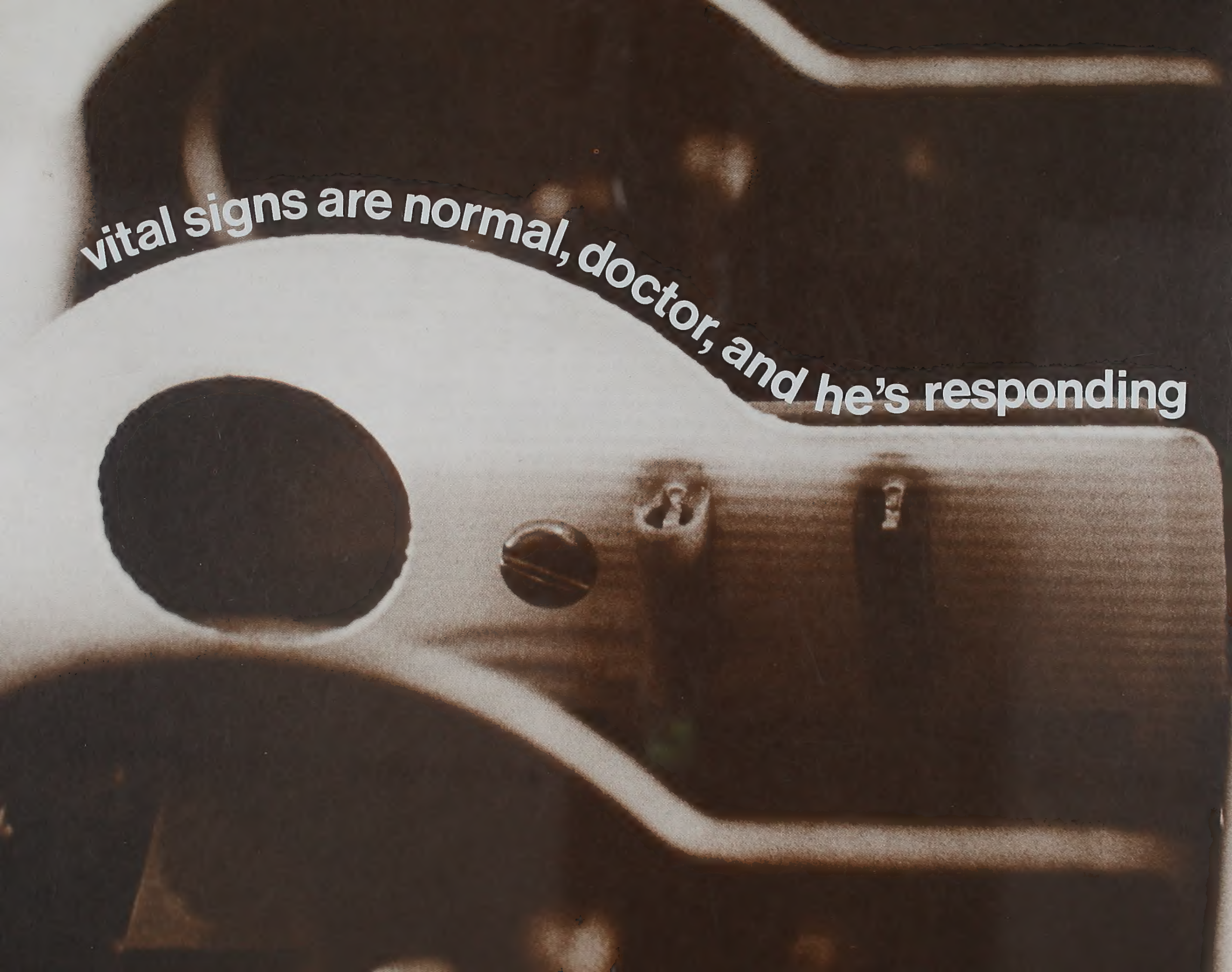
I refer you to the many achievements of 1977, which are outlined in the Directors' Report. In the years ahead, the Company and its employees will continue to make use of modern technology to ensure a high quality, efficient telecommunication network tailored to the needs of its customers.

I.E.H. Duvar

Chairman of the Board
& President

Charlottetown, P.E.I.
April 11, 1978


GHI
4
JKL
5
we can install your phone tomorrow morning if that's


vital signs are normal, doctor, and he's responding

Directors' Report

GROWTH IN SERVICE AND TECHNOLOGY

During 1977, the Company continued its efforts to provide for growth and improvement in telecommunication service through the use of modern telecommunications technology. A wide variety of services continued to grow and develop during the year, testimony to the continuing expansion of the telephone network.

In 1977, 2,971 telephones were added to the network — a net increase of 5.7 per cent. This brought the total number of phones in service to 55,296, or 46 telephones per 100 people in Prince Edward Island, compared to 45 in the previous year; and more than 62 per cent of residential customers now have the convenience of one-party service.

The program to connect all customers to dial service was completed with the conversion of six exchanges to dial operation in 1977 — Georgetown, Cardigan, Eldon, Mount Stewart, South Lake and Tyne Valley. Now all telephones in Prince Edward Island are dial operated, while at the end of 1976 95 per cent of telephones were dial operated. With the completion of this program, all telephones have access to Direct Distance Dial (DDD) and can dial any of the 170 million telephones in North America.

Increased Calling Volumes

The volume of calling grew in proportion to the increase in telephones in service — by almost six per cent. Long distance calling increased by 9.2 per cent to a record total of 4.48 million calls, the largest annual volume in the Company's history. Eighty-five per cent of long distance calls are now direct-dialed by customers, a proportion which reflects increased access to DDD as a result of the dial conversion program.

The volume of long distance calling grew despite the elimination of thousands of long

distance calls through the introduction of Extended Area Service affecting eight exchanges. At year end, 96.4 per cent of all Company customers had toll free calling to a neighboring exchange as a result of this program.

Improved Services

The service improvement programs for all-dial and all-DDD were completed on schedule, and progress was made in other service improvement programs.

The all-dial program resulted in the elimination of the remaining 3000 magneto telephones in service in the province. Extended Area Service provided calling without long distance charges among Georgetown, Cardigan and Montague, and between Mount Stewart and Charlottetown, with a modest increase in monthly rates replacing long distance charges in these exchanges.

In rural areas, extensive additions to our cable facilities provided additional circuits to reduce the number of customers sharing multi-party lines. In 1976, party lines averaged 4.8 customers per line; by the end of 1977 this average was reduced to 4.2. This program, which will continue in 1978, will reduce the average further to 4.0.

In a number of exchanges, the "base rate areas" were enlarged. Beyond these areas, monthly mileage rates are charged for one-party and four party service. The elimination of these mileage charges was extended in the Summerside area to include East Royalty, Reeves Estate, Kinloch, York Point and Crossroads.

The Company also continued its policy of burying cables and wires whenever possible, and this program reduces the possibility of service disruption due to ice storms and poor weather generally. Nearly 360 miles of cable and wire were buried during 1977.

New Services

Due in part to an aggressive marketing program in 1977 there was a continuing strong demand for paging services. During 1977 a new tone-and-voice paging service was introduced with a significant number of customers subscribing to this improved paging service, and by year-end, 198 customers were taking advantage of either tone only or tone-and-voice paging service.

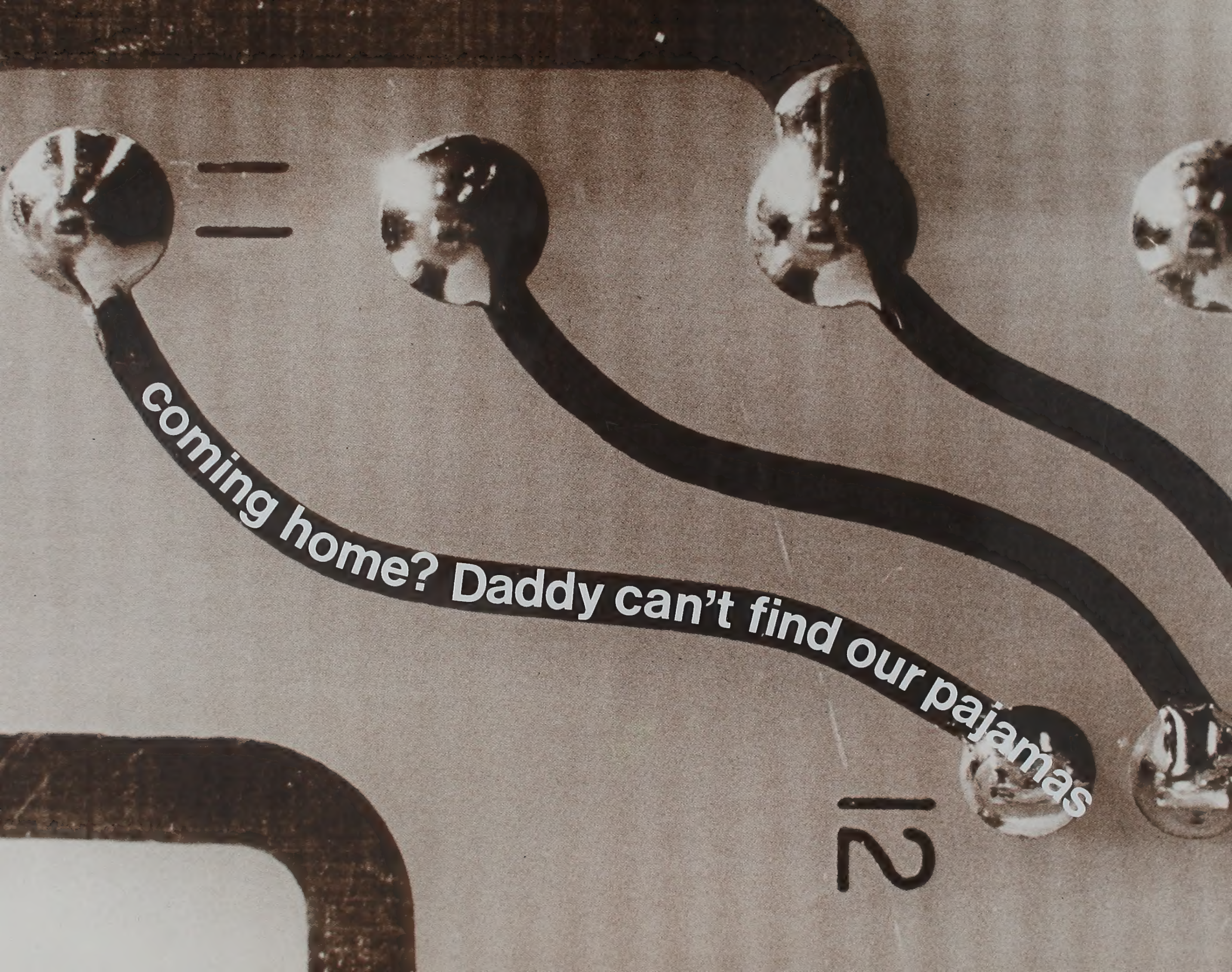
Mobile telephone service for trucks and automobiles was expanded with new facilities at Murray River to serve the eastern portion of the Island. Charlottetown and Summerside had previously received this service.

Touch-Tone telephones continued to increase in popularity in 1977, and additional businesses and residences requested and received this service. Premium-priced services such as Contempra or colored telephones and extension telephones continued to gain customer use and approval. By year end, the number of color sets in service had grown to 14,412, Contempra sets to 2,765, and residence extensions to 8,326.

The provincial telecommunications network was connected to the national Dataroute network in 1977. This high speed data network, operated jointly by Island Tel. and the other major telecommunications carriers in Canada, moves high volumes of computer data for business and institutional customers, in error-free digital form, between major centres across the country.

In late 1976, the Company provided two microwave channels from Nova Scotia to Charlottetown to bring in cable television channels for the local cable television operator, and in 1977 these channels were extended to Summerside.


if you can ship it Tuesday, we can meet our schedule


coming home? Daddy can't find our pajamas
12

Expansion of the Network

The Company faced the heaviest workload in its history to meet customer demands for an extra 3,000 telephones in service during 1977. Installation crews worked some 22,955 "in" and "out" orders to install 12,903 telephones and remove 9,992.

Because of the growing number of telephones, calling capacities in most of the Company's 26 exchanges were expanded. A new $1.5 million switching centre at Crossroads — part of the Charlottetown exchange area — was completed as part of this expansion. The additional cable, switching and transmission facilities necessary to meet this growth accounted for $4.7 million of the year's $8.9 million capital expenditures budget.

To meet present and future growth requirements the Company spent $290,000 to expand switching equipment facilities in Summerside, New Haven and Kensington exchange offices. The year 1977 also saw the start of a new switching centre in the Montague exchange. This included a new building to house a modern computerized switching machine involving a capital expenditure of some $942,300. This was determined to be the most economical and efficient way to replace and expand the present fully extended facilities now in use and at the same time to improve service.

In response to the continuing growth in long distance calling, the Company completed a major expansion of long distance facilities in the main; Charlottetown long distance switching office. This program, costing $250,000, will add nearly 300 additional trunk circuits linking the long distance centre to local exchanges throughout the province, as well as additional circuits for out of province calling.

The service improvements noted earlier required an additional $3.2 million. Finally, one million dollars was required for the removal and replacement of worn out plant and equipment.

With the completion of the all-dial, all-DDD portions of the service improvement program, it is expected that capital expenditures for 1978 will be reduced compared to 1977. The estimated capital expenditures for 1978 are $7.5 million. The Company anticipates continuing growth in the network with an estimated demand for 2,800 new telephones in 1978.

This growth will require the Company to process an estimated 24,600 orders for changes, removals, additions and upgrades in 1978 with a net increase of one telephone for each 8 orders. These changes will, in turn, require additional cable, switching and transmission facilities to provide sufficient calling volume capacity for both local and long distance service.

In addition, the Company plans a series of ongoing service improvements in 1978 and beyond. In rural areas, party-line sharing will be reduced from the present average of 4.2 to 4.0. Between the four pairs of exchanges, Tyne Valley and Summerside, Eldon and Charlottetown, Eldon and Vernon River, and New London and Summerside toll free calling will be introduced to eliminate long distance charges; and in Charlottetown there will be further enlargement of the base rate area to include the nearby Winsloe area.

The Company's People

At year-end, Island Tel employed 299 people — 165 men and 134 men — compared to 288 a year ago. Their salaries and wages in 1977 totalled $4,125,041.

In addition, Island Tel paid $734,156, or 17.8 per cent of the payroll, as follows:

- — $542,250 in payments by the Company to the non-contributory pension plan;
- — $92,885 in payments for sickness, accident, group insurance and supplementary hospital insurance;
- — $45,671 in payments to the Canada Pension Plan;
- — $53,350 in payments for Unemployment Insurance.

Training — Throughout the year 89 craft, traffic operators and management people attended special Company training courses within and outside the province.

Safety — The Company constitutes to provide information and guidance to all employees with regard to safe practices, both on and off the job. Safety performance is of prime importance to both the efficiency of the Company and the welfare of its employees. One hundred twenty-six employees earned safe driving awards representing nearly one thousand years of accident free driving for an average of 7.82 years per driver.

Late in the year, a number of changes in the organization were implemented:

James L. Cameron, Assistant Secretary and Staff Supervisor of Administration, was named General Administration Manager, retaining his responsibilities as Assistant Secretary.

David C. Barlow, who had been Staff Assistant — Operations, became Staff Supervisor of Administration.

Stanley L. Godfrey was appointed Plant Manager; Mr. Godfrey had been Supervisor of Installation and Repair.

Arthur E. Holland, Supervisor of Trunks and Switching, was appointed Commercial Manager.

David W. McLane, who had been Commercial Manager, was appointed to the new post of Marketing Manager.

Donald C. Rogers, who was Repair Foreman, became Supervisor of Installation and Repair.

Roger E. Meek, who was Trunks and Switching Foreman, became Supervisor of Trunks and Switching.


about that data our computer got by phone last night
LT2


to offer you the job at the salary we discussed

Summing Up

The Company has grown and evolved in direct response to the continuous needs of its customers. To provide the high level of service expected and required by them has necessitated the use of the most modern telecommunications technology available; and technology has been an essential factor in the Company's ability to provide fast, personal service to meet the telecommunication service requirements of the public.

The Company's wide variety of services provides speedy, accurate, low-priced telecommunications — ranging from voice communications to data transmission, and from local to long distance service. These services are woven into the fabric of the social and business community and they will continue to play a vital role in the future economic development of Prince Edward Island.

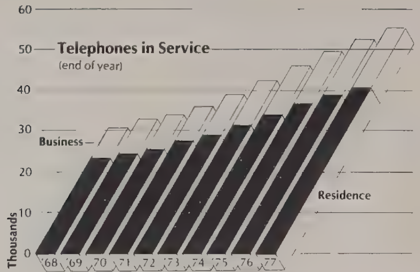
The highly-skilled employee team at The Island Telephone Company will continue to combine its desire to serve with the latest technology, in order to provide a consistently high standard of telecommunications service in the years ahead.

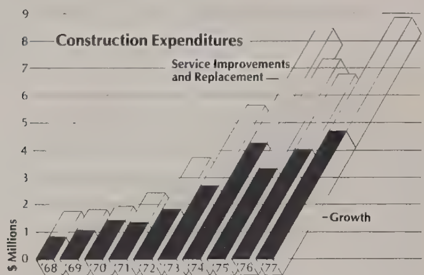
For the Board of Directors

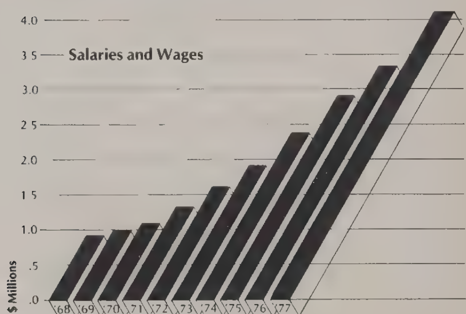
I.E.H. Duvar
Chairman of the Board
& President

Charlottetown, P.E.I.

May 2, 1978







THE FINANCIAL REVIEW

For the year 1977 total operating revenues were $14,234,200, up from $11,416,700 in 1976. The additional revenues resulted from a 5.7 per cent increase in telephones in service and a 9.2 per cent increase in long distance calling, along with the increase in tariff rates approved by the Public Utilities Commission effective March 1, 1977. Total operating expenses were $9,199,500 for the year compared to $7,361,400 in 1976. These changes, along with the changes in the other income and expense components, resulted in a significant improvement in earnings over 1976.

Net income for the year was $1,853,800, up from $1,349,400 a year earlier. This increased net income was required to pay the $450,700 in preference dividends and $854,500 in common dividends to support the equity investment by shareholders which, at year end, amounted to $18,415,100. The balance of net income of $548,600 was retained and reinvested in the business to help pay for the telephones, cables, switches, and other equipment necessary to provide telephone service.

Earnings per average common share rose from $1.61 for 1976 to $1.74 for the year just ended. Likewise, the return on average invested capital increased from 10.0 per cent to 10.4 per cent and the return on average common equity was 14.1 per cent, up from 13.5 per cent for 1976.

During the year, the Company had record high capital expenditures for plant and equipment of $8.9 million. To finance these capital expenditures, the Company had to obtain funds in the external capital markets to augment funds generated from internal sources, and during 1977 issued and sold $2.8 million of common stock consisting of 200,000 shares at $14 per share; $1.2 million of 9-1/4 per cent preference shares, and $2.5 million of 10-3/8 per cent Series L first mortgage bonds.

To meet the continuing customer requirements for telecommunications services, the Company has planned capital expenditures of $7,450,000 for 1978, and anticipates that earnings in the coming year will be adequate to support the external financing required to meet these capital expenditures.

in brief

	1977	1976
Earnings per common share	**$ 1.74**	$ 1.61
Dividends per common share	**$ 1.04**	$ .92
Return on average common equity	**14.1%**	13.5%
Return on average invested capital	**10.4%**	10.0%
Equity per common share, December 31	**$ 12.70**	$ 11.89
Construction program expenditures (thousands)	**$ 8,883**	$ 6,754
Telephone plant per telephone, December 31	**$ 939**	$ 857
Telephones in service, December 31	**55,296**	52,325
Long-term debt % total invested capital, December 31	**50.5%**	56.7%
Employees, December 31	**299**	288
Salaries and wages (thousands)	**$ 4,125**	$ 3,374
Average common shares	**804,964**	606,603

AUDITORS' REPORT

To the Shareholders of
The Island Telephone Company Limited:

We have examined the financial position statement of The Island Telephone Company Limited as at December 31, 1977 and the statements of income, retained earnings and sources of funds used for construction for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the sources of its funds used for construction for the year then ended in accordance with generally accepted accounting principles which, except for the changes in accounting practices explained in note 1(c) to the financial statements, have been applied on a basis consistent with that of the preceding year.

Clarkson, Gordon & Co.
Chartered Accountants

Halifax, Canada
January 31, 1978

INCOME STATEMENT
For the Year Ended December 31

	1977	1976
	$	$
OPERATING REVENUES		
Local service	**6,565,800**	5,210,400
Long distance service	**7,399,800**	5,974,800
Other	**330,800**	296,100
Uncollectible	*62,200*	*64,600*
	14,234,200	11,416,700
OPERATING EXPENSES		
Maintenance	**2,801,000**	2,157,700
Depreciation (Note 1(a))	**2,752,000**	2,200,200
Traffic	**1,151,400**	1,185,800
Commercial & marketing	**684,100**	523,900
Administrative	**695,300**	464,700
Pensions and other employee benefits	**484,700**	322,800
Other	**409,000**	303,100
Taxes other than income taxes	**222,000**	203,200
	9,199,500	7,361,400
	5,034,700	4,055,300
OTHER INCOME (Note 2)	**117,600**	86,500
	5,152,300	4,141,800
INTEREST		
Bond interest	**1,591,300**	1,371,300
Other (Note 3)	**185,100**	311,000
	1,776,400	1,682,300
	3,375,900	2,459,500
INCOME TAXES	**1,522,100**	1,110,100
NET INCOME	**1,853,800**	1,349,400
Preference Dividends	**450,700**	372,000
NET INCOME APPLICABLE TO COMMON SHARES	**1,403,100**	977,400
Earnings per common share	**1.74**	1.61

RETAINED EARNINGS STATEMENT
For the Year Ended December 31

	1977	1976
	$	$
RETAINED EARNINGS, beginning of year	**3,128,800**	2,804,800
ADDITIONS:		
Net income	**1,853,800**	1,349,400
DEDUCTIONS:		
Preference dividends	**450,700**	372,000
Common dividends	**854,500**	579,800
Commission and other expenses of issuing capital stock	**152,700**	73,600
	1,457,900	1,025,400
RETAINED EARNINGS, end of year	**3,524,700**	3,128,800

D.S. Inkpen,
Comptroller

ASSETS

TELEPHONE PLANT (Note 1(a))
Depreciable telephone plant in service
Other telephone plant (Note 4)

Less accumulated depreciation

Materials inventory

INVESTMENTS (Note 5)

CURRENT ASSETS
Cash
Accounts receivable
Prepayments

DEFERRED CHARGES
Unamortized long-term debt expenses
Other deferred charges

FINANCIAL POSITION STATEMENT
As at December 31

1977 $	1976 $
50,192,100	42,180,400
1,304,900	2,219,100
51,497,000	44,399,500
9,682,000	8,438,300
41,815,000	35,961,200
398,700	426,500
42,213,700	36,387,700
111,300	111,300
33,200	26,200
1,847,000	1,478,800
155,500	95,700
2,035,700	1,600,700
220,000	196,200
102,600	75,400
322,600	271,600
44,683,300	38,371,300

LIABILITIES AND SHAREHOLDERS' EQUITY

	1977 $	1976 $
SHAREHOLDERS' EQUITY		
Common stock (Note 6)	4,788,000	3,733,200
Premium on common stock (Note 7)	3,852,400	2,012,300
Retained earnings	3,524,700	3,128,800
Total common equity	12,165,100	8,874,300
Preference stock (Note 6)	6,250,000	5,050,000
	18,415,100	13,924,300
LONG-TERM DEBT (Note 8)		
First mortgage bonds	18,250,000	15,750,000
Bank and other notes	500,000	2,475,000
	18,750,000	18,225,000
CURRENT LIABILITIES		
Due to Maritime Telegraph & Telephone Company, Limited	171,500	335,700
Accounts payable	1,166,800	992,400
Income taxes accrued	396,100	32,000
Interest accrued	336,100	314,500
Other current liabilities	415,300	316,600
	2,485,800	1,991,200
DEFERRED CREDITS		
Income taxes (Note 1(b))	4,982,000	4,211,000
Other deferred credits	50,400	19,800
	5,032,400	4,230,800
	44,683,300	38,371,300

On behalf of the Board:

I.E.H. Duvar, Director — W.H.C. Leavitt, Director

The accompanying notes form an integral part of these financial statements

STATEMENT OF SOURCES OF FUNDS USED FOR CONSTRUCTION
For The Year Ended December 31

	Thousands of Dollars 1977 $	1976 $
SOURCE OF FUNDS:		
Internal —		
Operating revenues and other income	14,351,800	11,503,200
Less charges requiring working capital (Note 9)	9,041,800	7,237,200
Total internal — from Operations	5,310,000	4,266,000
External —		
Common stock	2,800,000	1,815,000
9-1/4% Preference shares — 1977 series	1,200,000	—
First mortgage bonds	2,500,000	2,500,000
Bank and other notes	500,000	2,475,000
Employees' stock savings plan (Note 6)	95,200	68,500
Decrease in materials inventory	27,800	—
Decrease in working capital	59,600	893,600
Total external	7,182,600	7,752,100
Total source of funds	12,492,600	12,018,100
Funds used for other than construction —		
Repayment of bank and other notes	2,475,000	4,540,000
Dividends	1,305,200	951,800
Other	128,400	50,600
Increase in materials inventory	—	50,200
Total funds used for other than construction	3,908,600	5,592,600
Total funds provided for construction	8,584,000	6,425,500
FUNDS USED FOR CONSTRUCTION:		
New telephone plant added	8,741,900	6,615,000
Cost of removing old plant	141,000	139,100
Construction program expenditures	8,882,900	6,754,100
Less charges not requiring working capital		
—Allowance for funds used during construction	115,000	83,600
—Salvage and Other	183,900	245,000
	298,900	328,600
Total funds used for construction	8,584,000	6,425,500

NOTES TO FINANCIAL STATEMENTS

1. **Summary of significant accounting policies —**

   (a) Accounting for telephone plant:

   Telephone Plant is carried at cost.

   Depreciation is charged on a straight-line basis using component rates for classes of plant, determined by a continuing program of engineering studies, as approved by the Public Utilities Commission of the Province of Prince Edward Island. These rates provide for depreciating the assets over their estimated useful service lives and resulted in a composite rate for 1977 of 6.1% (1976, 5.6%).

   Materials inventory consists of items which will be used in the construction program.

   (b) Income taxes:

   Deferred tax accounting has been followed with respect to all timing differences.

   (c) Changes in accounting practices:

   The Company together with other telecommunications companies has made certain changes in the application of accounting principles to bring their accounting practices more in line with other industries. These revisions refer mainly to certain corporate overheads which are not readily identifiable with or do not vary directly with construction of telephone plant.

   The revisions were approved by the Public Utilities Commission of the Province of Prince Edward Island to be effective July 1, 1977, and were included in the allowable costs of the Company for the determination of its revenue requirements.

   The costs which previously would have been capitalized and recovered through depreciation resulted in an increased charge to Operating Expenses of approximately $50,700.

2. **Other income** — includes an allowance for funds used during construction of $115,000 (1976, $83,600), less other income charges.

3. **Other interest** — includes interest on bank and other notes of $160,300 (1976, $285,700) and amortization of long-term debt expenses amounting to $16,400 (1976, $16,900).

4. **Other telephone plant** — land and telephone plant under construction.

5. **Investments** — include investment, at cost, in miscellaneous physical property ($51,300) and shares of Telesat Canada ($60,000).

6. **Capital Stock —**

	1977	1976
Authorized	$20,000,000	$10,000,000

Issued:	Shares Outstanding at Jan. 1, 1977	Issued For Cash	Shares Outstanding at Dec. 31, 1977
Common, par value $5.00	746,631	210,978	957,609
Preference			
4-1/2% par value $10.00	40,000		40,000
4-3/4% par value $10.00	40,000		40,000
5-1/2% par value $20.00	37,500		37,500
7-1/4% par value $20.00	75,000		75,000
9-1/4% par value $20.00	100,000		100,000
9-1/4% par value $20.00 1977 Series	—	60,000	60,000
	292,500	60,000	352,500
TOTAL ISSUED	1,039,131	270,978	1,310,109
Value at par, of issued common and preference shares	$8,783,200	2,254,800	11,038,000

The Company's authorized share capital was increased by Shareholder approval on May 28, 1977, to $20,000.000.

Early in the year, the Company reserved 13,000 common shares for issuance under the Employees' Stock Savings Plan. By the end of the year the Company issued 10,978 shares to employees under the terms and conditions of the Plan. These shares are generally issued in December of each year after the completion of twelve months of contributions at a purchase price equivalent to 80% of the average market price of the stock.

4-1/2%, 4-3/4%, and 5-1/2% Preference Shares

These shares are non-voting unless eight quarterly dividends are in arrears. The Company may redeem the shares at any time, upon giving thirty days notice to the holders, at par plus a stated premium in each case and any accrued but unpaid dividends.

7-1/4% Preference Shares

These shares are non-voting unless eight quarterly dividends are in arrears. On or before June 15, 1978, these shares are redeemable at the option of the Company, upon giving thirty days notice to the holders, at par, together with accrued and unpaid dividends to the date of redemption, plus a premium of $1.20. The premium thereafter decreases $.20 every three years until June 15, 1990, after which date the remaining shares are redeemable at a price of $20.20.

9-1/4% Preference Shares

These shares are non-voting unless eight quarterly dividends are in arrears. The shares are not redeemable prior to June 15, 1979. On or after June 15, 1979, these shares are redeemable, at the option of the Company, upon giving thirty days notice to the holders, at par together with accrued and unpaid dividends plus a premium of $1.45. The premium thereafter decreases $.20 every three years until June 15, 1997, after which date the remaining shares are redeemable at a price of $20.20.

9-1/4% Preference Shares — 1977 Series

These shares are non-voting unless eight quarterly dividends are in arrears. These shares are not redeemable prior to April 15, 1982. On or after April 15, 1982, these shares are redeemable, at the option of the Company, upon giving thirty days notice to the holders, at par, together with accrued and unpaid dividends plus a premium of $1.45. The premium thereafter decreases $.20 every three years until April 15, 2000, after which date the remaining shares are redeemable at a price of $20.20.

7. Premium on common stock —

	1977	1976
Beginning of year	**$2,012,300**	$1,004,200
On shares issued during year	**1,840,100**	1,008,100
End of year	**$3,852,400**	$2,012,300

8. Long-term debt —

(a) First mortgage bonds —

Series	Rate	Maturing	Principal
D	5-1/2%	May 1, 1978	$ 500,000
E	5-1/2%	October 2, 1981	500,000
F	5-1/2%	June 15, 1983	750,000
G	7-3/8%	February 1, 1988	1,000,000
H	8 %	December 15, 1991	3,000,000
I	9-1/4%	December 15, 1993	4,000,000
J*	11 %	January 15, 1995	3,500,000
K	11 %	March 31, 1996	2,500,000
L	10-3/8%	June 1, 1997	2,500,000
			$18,250,000

*The holders of Series J Bonds have the right to require the Company to repay the principal amount at par on January 15, 1985.

The First Mortgage Bonds are secured by a Deed of Trust and Mortgage and by deeds supplemental thereto containing a first and specific mortgage and charge upon the Company's land, buildings, plant and equipment and a first floating charge upon all other property, assets and rights of the Company, present and future, wheresoever situate.

(b) Bank and other notes —

Bank demand loans at prime rate	$500,000

In order to permit the Company to time its new issues of debt or capital most advantageously the Company maintains a substantial bank line of credit and from time to time sells short-term promissory notes. Such short-term credit is replaced in the normal course by longer term financing and currently maturing debt issues are likewise normally refinanced. For this reason, the Company does not classify these items as current liabilities.

Likewise, the Company does not classify as current assets excess funds received through financing and temporarily invested in short-term investments.

9. Charges requiring working capital —

	1977	1976
Operating expenses, interest and taxes	**$12,498,000**	$10,153,800
Less Charges not requiring working capital		
—Depreciation	**2,752,000**	2,200,200
—Deferred income taxes	**771,000**	752,600
—Other	**48,200**	47,400
	3,571,200	3,000,200
	8,926,800	7,153,600
Add credits not producing working capital		
—Allowance for funds used during construction	**115,000**	83,600
	$ 9,041,800	$ 7,237,200

10. Pension Fund —

Pension Fund Obligations are accounted for and paid over the estimated future working lifetime of employees of the Company. The contribution to the pension fund for the year ended December 31, 1977 amounted to $542,300 (1976, $352,300). The actuarial reviews as of December 31, 1976, based on earnings and service to that date, show that all vested benefits are fully funded.

11. Anti-Inflation Act —

The Company is subject to the Anti-Inflation Act which provides authority for the imposition of Anti-Inflation restraints from October 14, 1975, and in the Company's case is generally in force until December 31, 1978. The Act and the guidelines thereunder control profit margins, prices, dividends and compensation. The Anti-Inflation Act contains special provisions relating to the application of the guidelines to companies whose prices or profit margins are subject to approval by regulatory bodies. The Company is subject to regulation by the Public Utilities Commission of the Province of Prince Edward Island.

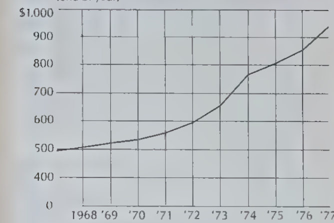
Section 4.1 (1) of the Anti-Inflation Act provides that any body that establishes or approves the prices or profit margins of any supplier to whom the guidelines apply shall, in exercising its powers, apply such guidelines as are applicable in the circumstances, modified to such extent, if any, as in the opinion of the body, is necessary to take into account the particular facts of the situation.

Management is satisfied that the Company is complying with the legislation and regulations thereunder.

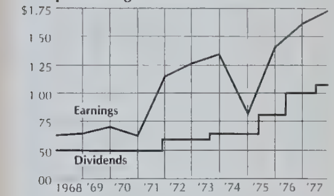
THE YEARS IN REVIEW

	1977	1976	1975	1974	1973	1972	1971	1970	1969	1968
Financial Position at Dec. 31 (in thousands)										
Telephone Plant	**$ 51,896**	$ 44,826	$ 39,676	$ 35,081	$ 27,753	$ 23,026	$ 19,947	$ 18,163	$ 16,888	$ 15,634
Accumulated depreciation	**9,682**	8,438	7,556	7,183	6,157	5,458	5,063	4,606	4,198	3,817
Investments	**111**	111	73	72	72	72	1,562	106	83	31
Current assets	**2,036**	1,600	1,973	1,346	1,006	755	614	553	514	619
Deferred charges	**323**	272	284	214	194	67	105	37	38	41
Shareholders' equity	**18,415**	13,924	11,717	11,291	9,229	8,778	6,942	6,571	6,481	6,347
Long term debt	**18,750**	18,225	17,790	12,723	10,230	7,125	8,000	5,906	5,210	4,620
Current liabilities	**2,486**	1,991	1,470	2,539	1,003	746	647	422	390	447
Deferred credits	**5,033**	4,231	3,473	2,977	2,406	1,813	1,576	1,354	1,244	1,094
Income (in thousands)										
Operating revenues	**$ 14,234**	$ 11,417	$ 9,776	$ 7,648	$ 6,548	$ 5,440	$ 4,784	$ 3,903	$ 3,589	$ 3,274
Operating expenses	**9,200**	7,362	6,497	5,385	4,253	3,494	3,013	2,690	2,385	2,204
Other income	**118**	86	235	87	70	24	15	9	10	11
Interest	**1,776**	1,682	1,463	927	615	495	432	401	313	259
Income taxes	**1,522**	1,110	888	684	829	672	654	409	451	410
Net income for year	**1,854**	1,349	1,163	739	921	803	700	412	450	412
Statistics — at December 31										
Telephone Plant per telephone	**$ 939**	$ 857	$ 807	$ 765	$ 656	$ 593	$ 559	$ 534	$ 523	$ 510
Equity per common share	**$ 12.70**	$ 11.89	$ 11.66	$ 11.10	$ 11.16	$ 10.48	$ 9.95	$ 9.35	$ 9.27	$ 9.09
Embedded debt cost	**9.4%**	9.2%	8.9%	8.1%	8.1%	6.8%	7.4%	7.1%	5.9%	5.9%
Long term debt % total invested capital	**50.5%**	56.7%	60.3%	53.0%	52.6%	44.8%	53.5%	47.3%	44.6%	42.1%
Employees	**299**	288	279	297	258	259	225	221	198	197
Telephones in service	**55,296**	52,325	49,156	45,866	42,314	38,841	35,715	33,999	32,314	30,683
Dial telephones	**100%**	94.6%	91.2%	87.4%	83.5%	78.7%	76.7%	73.9%	74.1%	72.1%
Shareholders	**3,285**	2,828	2,626	2,615	2,192	2,160	1,791	1,788	1,812	1,838
Statistics — for year										
Earnings per common share	**$ 1.74**	$ 1.61	$ 1.40	$ .82	$ 1.34	$ 1.26	$ 1.15	$ .63	$ .70	$ .64
Average common shares	**804,964**	606,603	562,878	554,315	549,281	544,636	540,084	535,216	530,432	525,706
Dividends per common share	**$ 1.08**	$ 1.00	$ .74	$ .65	$ .62	$ .60	$ .51	$ .50	$ .50	$ .50
Times bond interest earned - before taxes	**3.2**	3.0	3.1	3.0	5.3	4.15	4.95	3.66	5.54	5.04
Times bond interest earned - after taxes	**2.3**	2.2	2.3	2.1	3.4	2.74	3.14	2.43	3.48	3.13
Return on average invested capital	**10.4%**	10.0%	9.5%	7.8%	8.8%	8.8%	8.7%	6.7%	6.7%	6.3%
Return on rate base	**9.1%**	8.6%	8.1%	6.7%	7.7%	8.0%	7.8%	6.1%	6.1%	5.8%
Return on average common equity	**14.1%**	13.5%	12.4%	7.2%	12.3%	12.3%	12.0%	6.7%	7.6%	7.0%
Construction program expenditures (in thousands)	**$ 8,883**	$ 6,754	$ 7,298	$ 8,423	$ 5,648	$ 3,702	$ 2,429	$ 1,951	$ 1,835	$ 1,715
Salaries and wages (in thousands)	**$ 4,125**	$ 3,374	$ 2,910	$ 2,382	$ 1,919	$ 1,606	$ 1,324	$ 1,096	$ 995	$ 911
Average daily toll messages (in thousands)	**12**	11	10	9	9	8	7	6	6	5

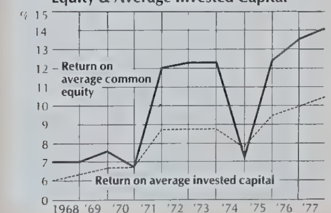
Telephone Plant per Telephone
(end of year)



Earnings and Dividends per Average Common Share



Rates of Return on Average Common Equity & Average Invested Capital



THE ISLAND TELEPHONE COMPANY LIMITED

DIRECTORS

* **A. Gordon Archibald**
Chairman of the Board
Maritime Telegraph & Telephone Co., Ltd.
Halifax, N.S.

* **Walter C. Auld**
Executive Vice President
The Island Telephone Company Limited
Charlottetown, P.E.I.

* **Ivan E. H. Duvar**
Chairman of the Board & President
The Island Telephone Company Limited
Charlottetown, P.E.I.

Charles J. Fraser
President
Montague Drive-In Theatre Ltd.
Montague, P.E.I.

* **Edward J. Hicks**
Vice President (Finance)
The Island Telephone Company Limited
Charlottetown, P.E.I.

John J. Howatt
President
Darlington Farms Ltd.
Darlington, P.E.I.

William Herbert C. Leavitt
President
The Leavitt's Maple Tree Craft
Alberton, P.E.I.

* **Horace R. MacFarlane**
President
The Prince Edward Island Bag Company, Limited
Summerside, P.E.I.

* **Percy J. Smith**
Vice President
Great Eastern Corporation Ltd.
Halifax, N.S.

*Member Executive Committee

OFFICERS

Ivan E. H. Duvar
Chairman of the Board & President

Walter C. Auld
Executive Vice President

Edward J. Hicks
Vice President (Finance)

Donald R. Livingstone
General Manager

David S. Inkpen
Comptroller

Donald B. Quinn
Treasurer

Stephen E. Jefferson
Secretary

James L. Cameron
Assistant Secretary & General Administration Manager

OPERATIONS

James L. Cameron
Assistant Secretary

- **D. C. Barlow**
  Staff Supervisor — Administration

K. M. Frizzell
Operator Services Manager

S. L. Godfrey
Plant Manager

- **R. Livingstone**
  Supervisor - Construction
- **R. E. Meek**
  Supervisor — Trunks & Switching
- **D. C. Rogers**
  Supervisor — Installation & Repair
- **P. A. Trainor**
  Engineering Supervisor — Outside Plant

A. E. Holland
Commercial Manager

D. W. McLane
Marketing Manager

interim report

second quarter / 1977

File

THE ISLAND TELEPHONE COMPANY LIMITED

condensed financial position statement

	As at June 30th	
	1977*	1976
	$	$
Telephone plant	**49,175,008**	41,928,644
Accumulated depreciation	**9,048,136**	7,991,861
Investments	**111,332**	72,571
Current assets	**1,817,483**	1,596,484
Deferred charges	**371,740**	389,395
Shareholders' equity — Preference	**6,250,000**	5,050,000
— Common	**9,177,318**	6,895,351
Long-term debt — First mortgage bonds	**18,250,000**	15,750,000
— Bank and other notes	**1,750,000**	2,790,000
Current liabilities	**2,288,780**	1,592,862
Deferred credits	**4,711,329**	3,917,020

interim income statement

	Three Months Ended June 30th		Six Months Ended June 30th	
	1977*	1976	**1977***	1976
	$	$	**$**	$
Operating revenues	**3,517,511**	2,824,855	**6,707,209**	5,578,876
Operating expenses and other taxes (Notes 1 & 3)	**2,248,435**	1,808,292	**4,217,295**	3,608,397
	1,269,076	1,016,563	**2,489,914**	1,970,479
Other income	**34,304**	17,945	**59,323**	26,912
Income before interest and income taxes	**1,303,380**	1,034,508	**2,549,237**	1,997,391
Interest	**444,312**	415,441	**870,374**	818,454
	859,068	619,067	**1,678,863**	1,178,937
Income taxes (Note 2)	**381,106**	280,168	**751,563**	537,706
Net income	**477,962**	338,899	**927,300**	641,231
Dividends on preference shares	**116,228**	93,003	**209,231**	186,006
Net income applicable to common shares	**361,734**	245,896	**718,069**	455,225
Earnings per average common share	**$ .48**	$ .43	**$ .96**	$ .80
Average number of common shares outstanding	**746,631**	571,578	**746,631**	571,548
(Note 1) Includes depreciation of	**$ 613,840**	$ 546,485	**$1,209,402**	$1,088,674
(Note 2) Consists of:				
Income taxes payable	**$ 181,878**	$ 137,568	**$ 354,028**	$ 221,437
Income taxes deferred	**$ 199,228**	$ 142,600	**$ 397,535**	$ 316,269

(Note 3) The Company will apply in the year 1977 to the Prince Edward Island Public Utilities Commission for a revision to its depreciation rates, such rates to be effective January 1, 1977. The revised rates, if approved will result in an increase in depreciation expense of $47,035 for the three months ended June 30, 1977 and $93,766 for the six months ended June 30, 1977. Earnings per share will decrease from $ .48 to $ .45 for the three months ended June 30, 1977. Earnings per share will decrease from $ .96 to $ .89 for the six months ended June 30, 1977.

*Unaudited

statement of sources of funds used for construction

	Six Months Ended June 30th	
	1977*	1976
	$	$
SOURCE OF FUNDS:		
Internal —		
Operating revenues and other income	**6,766,532**	5,605,788
Less charges requiring working capital	**4,257,052**	3,544,373
Total internal — from operations	**2,509,480**	2,061,415
External —		
$9^1/_4$% Preference Shares — 1977 Series	**1,200,000**	—
First mortgage bonds	**2,500,000**	2,500,000
Bank and other notes	**1,750,000**	2,790,000
Employees' stock savings plan	**43,699**	32,230
Decrease in working capital	**72,130**	499,502
Total external	**5,565,829**	5,821,732
Total source of funds	**8,075,309**	7,883,147
APPLICATION OF FUNDS:		
Repayment of bank and other notes	**2,475,000**	4,540,000
Dividends	**582,545**	414,629
Increase in materials inventory	**22,320**	417,952
Other	**106,865**	26,305
Total application of funds (other than construction)	**3,186,730**	5,398,886
Total funds provided for construction	**4,888,579**	2,484,261
FUNDS USED FOR CONSTRUCTION:		
New telephone plant added	**4,993,433**	2,557,099
Cost of removing old plant	**54,639**	81,428
Construction program expenditures	**5,048,072**	2,638,527
Less charges not requiring working capital		
— Allowance for funds used during construction	**64,740**	25,955
— Salvage	**80,174**	116,255
— Other	**14,579**	12,056
	159,493	154,266
Total funds used for construction	**4,888,579**	2,484,261

*Unaudited

Mechanized trouble-shooting was commenced May 2 with introduction of ATRAPS — automatic trouble reporting and patterning systems — to aid in pinpointing long distance network problems before they can impair service.

Work neared completion for conversion of telephones in the Georgetown exchange in mid-July to automatic dial operation, as well as giving customers in that community access to the Direct Distance Dial network. Project cost $495,000, involved 267 telephones, and will provide no-toll calling to nearby Cardigan and Montague by the end of August.

Quarter century service awards went to Keith Dalziel, Installation Foreman, (right), and Donald Livingstone, General Manager, (Centre). Presenting awards was I.E.H. Duvar.

To the shareholders:

Increases in long distance calling volumes of 10.9 per cent and in telephones in service of 6.0 per cent (see box, right), coupled with introduction of both Dataroute and Datapac services for the Province, reflect the continuing demand for telecommunications services delivered by your Company. Dataroute is a cross-Canada private data transmission service using modern, on-off "digital" pulses. Datapac, like telephone service itself, is a public data network which moves low-cost "packages" of data from source to finish.

Provision of 1,261 additional telephones to the network to date this year necessitated the installation, change, addition and removal of 10,092 telephones. The increased calling requirements of these new phones, as well as rising volumes of calling on the existing network, required additional switching and transmission facilities and related outside plant work. As well, construction of additional facilities proceeded for a range of service improvement projects — conversion of manual exchange to Dial Service, Direct Distance Dialing and Extended Area Service plans — leading up to completion of the all-dial, all-DDD programs by year end.

Total cost of these capital construction program requirements for the first six months was $5,048,068, and estimated capital expenditures for the year are $9,000,000. The funds required are generated both from internal sources and from external capital markets. In April, a $9^{1}/_{4}$ per cent cumulative, redeemable, preference share issue yielded $1.2 million, and in June a $10^{3}/_{8}$ first mortgage per cent Series "L" bond issue yielded $2.5 million.

Earnings per share to date were $.96, compared to $.80 for the same period a year ago, with the most recent quarter reflecting the full impact of a general increase in rates approved for implementation March 1. The rate of return on total invested capital was 10.7 per cent, compared to 9.9 per cent a year ago, and the return on common equity was 15.9 per cent compared to 13.5 per cent. However, because of rising costs of materials and labor, and the cost of further external financing, the Company expects to achieve earnings on common equity for the full year of approximately 14 per cent.

At its meeting on July 29, the Board of Directors approved an increased dividend of $ .27 for the third quarter to be paid September 15 to shareholders of record August 31. This is an increase from the last quarterly dividend of $ .25.

I.E.H. Duvar
Chairman of the Board
& President

Charlottetown P.E.I.
August 1, 1977

Second Quarter Statistics
(Compared to Same Period Last Year)

LONG DISTANCE CALLS
2,130,204 up 10.9%
SALARIES AND WAGES
$1,963,596 up 26.1%
TELEPHONES IN SERVICE
53,586 up 6.0%
EMPLOYEES
350 up 14.8%